UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

CIVIL ACTION NO. 99-11051-GAO

UNITED STATES OF AMERICA,
Plaintiff

v.

BRIDLE PATH ENTERPRISES, INC.,
formerly known as American Health Care Enterprises, Inc.;
DAWN LUEDECKE; and GREGORY JONES,
Defendants

MEMORANDUM AND ORDER
December 4, 2001

O'TOOLE, D.J.

The United States moves for summary judgment in its favor arguing that the defendants are personally liable for the Medicare overpayment debt Bridle Path Enterprises owes the United States. While Bridle Path's owners, Dawn Luedecke and Gregory Jones, do not dispute the principal amount Bridle Path owes to the United States, they argue that the undisputed facts do not support a finding that they are personally liable for the debt. Neither the government nor Luedecke and Jones contend that Bridal Path, a defunct corporation with no income, could satisfy its Medicare debt.

The record the parties have furnished to this Court sufficiently demonstrates that defendants Luedecke and Jones are personally liable for the Medicare debt because of their disregard for Bridle Path's corporate identity and because they violated the federal priority statute, 31 U.S.C. § 3713.

A. Summary of Facts

In 1991, defendants Dawn Luedecke and Gregory Jones, along with Luedecke's son (who is not a party to this case), incorporated American Health Care Enterprises, Inc. ("AHC"). AHC became a Medicare provider under an agreement that became effective August 23, 1991. During 1993, the Associated Hospital Service of Maine ("Associated Hospital") acted as AHC's fiscal intermediary. Under Medicare procedures, a provider submits claims for Medicare reimbursement to a fiscal intermediary who then makes payments to the provider based on cost estimates. See 42 U.S.C. § 1395h. These payments, however, are subject to later adjustment when the "reasonable cost" for the claims is determined. See id. § 1395g. In 1996, when Associated Hospital made its final audit of AHC's annual cost report for 1993, it determined that AHC had an outstanding overpayment of $231,568. Gov't Exs. at 111-15. AHC did not timely file a request for an administrative hearing to dispute the overpayment determination under 42 C.F.R. § 405.1841. Instead, in June 1996, AHC asked for an extended repayment plan for the Medicare debt. Gov't Exs. at 170-75. Ultimately, the Health Care Financing Administration's Regional Office granted AHC a thirty month repayment schedule. Gov't Exs. at 209.

AHC made scheduled repayments to Medicare through July 1997. Gov't Exs. at 210. AHC placed a "stop payment" order on its August payment. Gov't Exs. at 211.[1] The July 1997 payment was the last payment AHC made to Medicare. As of that time, AHC had repaid $166,760.16 of the $231,568.00 principal balance, leaving $64,807.84 outstanding. Gov't Exs. at 177. The defendants do not contest this calculation. The government also claims that it is owed an additional $735.84

[1] In her deposition, Luedecke testified that she issued the stop payment because the Internal Revenue Service ("IRS") had instructed her not to make any other payments until she had paid the IRS. Gov't Exs. at 38-40. However, Medicare was the only corporate payment as to which she placed a stop payment order. Gov't Exs. at 40, 42.

per month in interest from May 20, 1996, through the date of this judgment. Gov't Exs. at 116-19. The defendants say that they dispute this amount, but they offer no alternative calculation.

In late 1996 or early 1997, the defendants began to try to sell AHC's assets. On March 28, 1997, AHC and Prism Home Care, Inc. ("Prism") executed a purchase and sale agreement for the assets which specified a sale price of $750,000 payable at closing, and up to another $750,000 if Prism achieved certain net revenues within the first year of operation. Gov't Exs. at 225-62. At the end of June 1997, AHC's Profit and Loss Statement reflected a net loss of $290,291.88. Gov't Exs. at 266-69. On July 21, 1997, the contemplated transaction closed and AHC sold all its assets to Prism. On the same day, AHC changed its name to Bridle Path. Within days of the closing, AHC/Bridle Path notified Medicare of the sale, and informed Medicare that it was ceasing its participation in the Medicare program. Gov't Exs. at 110.

Between late 1996 and December 1997, AHC/Bridle Path wrote numerous checks to several entities out of its operating account. AHC/Bridle Path paid $40,000 to Luedecke, $56,3217 to American Health Care Affiliated Services, Inc. (a separate home health care agency owned by Luedecke and Jones), $6,800 to The Wesley Group (a real estate holding company owned by Luedecke and Jones), and $17,600 to Kathleen Sweeney (from whom Luedecke had acquired Caring Hands Physical Therapy). On July 24, 1997, Bridle Path paid $68,573.36 to D&W Contractors, who testify that this payment was for work at 17 Bridlepath Way, Luedecke's and Jones's private residence. Gov't Exs. at 310, 442-49. Furthermore, the payments to Luedecke and Jones out of Bridle Path's payroll account increased significantly after the asset sale. Prior to the sale, Jones had received weekly salary payments of $1,092.61. Gov't Exs. at 328, 330, 332, 334, 336. After the sale, this amount steadily increased to as much as $2,796.00, as well as an additional $14,496.90 on August 4. Gov't Exs. at 346-50, 352-56. Similarly, weekly payments to Luedecke from the payroll

account in the month prior to the sale totaled $6,346.50. In the month after the sale, Luedecke received one lump sum payment of $22,077.81 from the account. Gov't Exs. at 327, 329, 331, 333, 335, 351. Luedecke and Jones do not dispute or explain any of these payments.

B. Summary Judgment Standard

Summary judgment is appropriate when "there is no genuine issue as to any material fact" and "the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c). The moving party "must put the ball in play, averring an absence of evidence to support the nonmoving party's case. The burden then shifts to the nonmovant to establish the existence of at least one fact issue which is both 'genuine' and 'material.'" Garside v. Osco Drug, Inc., 895 F.2d 46, 48 (1st Cir. 1990) (citations omitted). The nonmovant cannot defeat a motion for summary judgment by relying on "mere allegations or evidence that is less than significantly probative"; the nonmovant "must present definite, competent evidence to rebut the motion." Libertad v. Welch, 53 F.3d 428, 435 (1st Cir. 1995)(citations omitted). However, the court "must view the entire record in the light most hospitable to the party opposing summary judgment, indulging all reasonable inferences in that party's favor." Griggs-Ryan v. Smith, 904 F.2d 112, 115 (1st Cir. 1990).

C. Piercing the Corporate Veil

Although the government sued Luedecke, Jones, and Bridle Path as defendants in this action, Bridle Path is defunct, and it appears that the corporation has little or no remaining assets and no income with which to pay any debts it may owe. What is at issue is whether Luedecke and Jones are personally liable to the government for Bridle Path's debt.

The government seeks to hold Luedecke and Jones personally liable by piercing Bridle Path's corporate veil. Whether to pierce a corporate veil to satisfy a monetary claim under a federal regulatory scheme like Medicare is decided by reference to federal common law.

See United States v. Kimbell Foods, Inc., 440 U.S. 715, 726 (1979); see also Town of Brookline v. Gorsuch, 667 F.2d 215, 220-21 (1st Cir. 1981) (discussing the application of federal law to veil piercing in connection with several other federal regulatory schemes). Federal law governs federal programs which "by their nature are and must be uniform in character throughout the Nation." Kimbell Foods, 440 U.S. at 728. While the First Circuit has not had occasion to rule whether Medicare is such a federal program, the Third Circuit has held that it is. See United States v. Pisani, 646 F.2d 83, 86 (3d Cir. 1981); see also United States v. Normandy House Nursing Home, 428 F. Supp. 421, 424 (D. Mass. 1977) (using federal law to evaluate the viability of a veil piercing argument in a Medicare overpayment case).

Federal law provides no single "litmus" test for determining when it is appropriate to pierce the corporate veil. Brotherhood of Locomotive Eng'rs v. Springfield Terminal Ry. Co., 210 F.3d 18, 26 (1st Cir. 2000). Instead, federal law is "founded only on the broad principle that a corporate entity may be disregarded in the interests of public convenience, fairness and equity." Id. The First Circuit has considered the veil piercing question predominately in the ERISA context. When deciding an ERISA veil piercing case, the First Circuit has evaluated three factors: (1) the respect shareholders pay to the corporate identity; (2) the fraudulent intent of defendants; and (3) the degree of injustice

to be visited on the litigants if the corporate entity is recognized. Crane v. Green & Freedman Baking Co., 134 F.3d 17, 22 (1st Cir. 1998). More broadly, factors that federal courts have used in evaluating requests to pierce the corporate veil include:

> failure to observe corporate formalities, non-payment of dividends, the insolvency of the debtor corporation at the time, siphoning of funds of the corporation by the dominant stockholder, non-functioning of other officers or directors, absence of corporate records, and the fact that the corporation is merely a facade for the operations of the dominant stockholder or stockholders.

DeWitt Truck Brokers v. W. Ray Flemming Fruit Co., 540 F.2d 681, 686-87 (4th Cir. 1976) (citations and footnotes omitted). Piercing the corporate veil requires a highly fact specific inquiry into the degree to which the defendants deliberately failed to treat their corporation and its assets as a entity separate from themselves. See Crane, 134 F.3d at 21.

The undisputed factual record clearly demonstrates that Luedecke and Jones did not treat AHC/Bridle Path as a separate entity, but rather treated its assets as their own. During 1997 Luedecke and Jones made numerous sizeable payments to themselves from AHC/Bridle Path's operations and payroll accounts, either directly or through one of their other companies. There is no evident rational business purpose to these payments, especially since AHC/Bridle Path was operating at a severe net loss at the time. In July 1997, when AHC/Bridle Path received an infusion of cash from its asset sale to Prism, the defendants used $68,573.36 of this income to pay for renovations to their personal residence. The defendants also funneled a generous portion of the proceeds into their own pockets in the months immediately following the sale. In contrast, the defendants did not apply any of the $750,000 Prism paid for AHC/Bridle Path's assets to the Medicare debt. Such wrongful diversion of corporate assets at a time when the corporation was failing, and in fact dissolving, justifies piercing the corporate veil. See Crane, 134 F.3d at 23.

The defendants argue that the court should not pierce the veil because they did not intend to defraud the government. The defendants' argument rests on two points. First, the defendants claim they did not make the required Medicare payments because the IRS instructed them not to pay anyone else before paying tax liabilities. Second, the defendants claim that they believed that the requirements for the contingency payment would be met, and that they would receive another $750,000 from Prism. However, the defendants' actions speak louder than their words. The Medicare payment was the only check on which they placed a "stop payment." The IRS's admonition did not prevent the defendants from making sizable payments to themselves. They also offer no explanation for why they used the money they received from Prism to pay themselves and to pay for home improvements instead of meeting the corporation's Medicare obligations. A strong inference of intentional fraud arises from these facts. The defendants offer no facts to defeat the inference – only their flat assertion. Nor do they offer any basis for making an objective assessment about the likelihood of the second payment from Prism. In any event, even if they legitimately might have anticipated more cash from Prism, that prospect does not counter the reality that they freely spent what cash the corporation did have in the summer of 1997 in their own interest. No genuine issues of material fact remain, and piercing the corporate veil to make the defendants personally liable is appropriate.

D. Federal Priority Statute Violations

Luedecke and Jones are also personally liable for the Medicare debt because they violated the federal priority statute, 31 U.S.C. § 3713(a)(1), which provides in relevant part that:

> A claim of the United States Government shall be paid first when –
> (A) a person indebted to the Government is insolvent and –
> (i) the debtor without enough property to pay all debts makes a voluntary assignment of property;
> (ii) property of the debtor, if absent, is attached; or
> (iii) an act of bankruptcy if committed; or
> . . . .
> (B)(2)(b) A representative of a person or an estate (except a trustee acting under title 11) paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims by the Government.

In other words, Luedecke and Jones are personally liable for the Medicare debt if at the time their corporation was insolvent they made a voluntary assignment of property to themselves or another entity instead of paying their government debts. The Supreme Court has placed the burden on the defendants to show that the priority statute should not apply to them. See Bramwell v. United States Fid. & Guar. Co., 269 U.S. 483, 487 (1926).

The defendants' various payments from August 1997 onward violated the federal priority statute. The June 30, 1997, Profit and Loss Statement demonstrates that the defendant's corporation was insolvent at that time. For purposes of the federal priority statute, a corporation is insolvent when its liabilities exceed its assets. Lakeshore Apartments, Inc. v. United States, 351 F.2d 349, 353 (9th Cir. 1965); United States v. Golden Acres, Inc., 684 F. Supp. 96, 101 (D. Del. 1988); United States v. Coyne, 540 F. Supp. 175, 179 (D.D.C. 1981); United States v. Dyna-Tex, Inc., 372 F. Supp. 280, 281 (E.D. Tenn. 1973).

As outlined above, after they stopped payment on their August payment to Medicare,

Luedecke and Jones made several payments to themselves out of AHC/Bridle Path's corporate accounts. These asset transfers violated the federal priority statute. See, United States v. Coppola, 85 F.3d 1015, 1020 (2d Cir. 1996) (finding defendant in violation of priority statute after distributing corporate assets to himself and family members instead of paying taxes); In re Gottheiner, 703 F.2d 1136, 1138-40 (9th Cir. 1983) (finding doctor in violation of priority statute after having his corporation make payments and loans to him personally instead of repaying Medicare debt); Coyne, 540 F. Supp. at 180 (finding defendant in violation of priority statute after assigning all of the corporation's assets to himself instead of repaying debt to United States). There is no reason not to conclude that the defendants are personally liable for the AHC/Bridle Path Medicare debt.

E. Government's Constructive Trust Theory

The government argues that the defendants also are personally liable for the Medicare debt as the constructive trustees of Bridle Path's assets. A court may impose a constructive trust "[w]hen property has been acquired in such circumstances that the holder of the legal title may not in good conscience [obtain] the beneficial interest." Broomfield v. Kosow, 212 N.E.2d 556, 561 (Mass. 1965)(alteration in original) (quoting Beatty v. Guggenheim Exploration Co., 122 N.E. 378, 385 (N.Y. 1919). The application of this equitable doctrine is not warranted in this case. Both the corporate veil piercing doctrine and the federal priority statute render Luedecke and Jones personally liable for the corporation's Medicare debt. No additional equitable remedy is needed to do justice.

F. Interest Calculation

Both parties agree that the principal amount remaining to be paid is $64,807.84. The government contends that the defendants owe an additional $735.84 in interest which has accrued every month since May 1996. The government set the interest rate on the debt at 13.625% under 42 C.F.R. § 405.378. The government then calculated that 13.625% of $64,807.84, divided by

twelve, is $735.84. This sum is due for every month since the defendants entered into their repayment agreement with the government in May 1996. The defendants state that they dispute the government's calculation, but they offer no supporting reasoning and no alternative interest calculation. Further, the government's approach is kind to the defendants since interest is not compounded, and it does not appear to have been assessed on any of the repaid $166,760.16 of the original principal balance.

In conclusion, the government's motion for summary judgment is GRANTED. Luedecke and Jones are personally liable for the outstanding principal of $64,807.84 Bridle Path owes to Medicare and for $48,565.44 in interest on that debt.[2]

Judgment shall enter accordingly.

_____ _____

DATE DISTRICT JUDGE

[2] The interest is calculated from May 20, 1996 through November 26, 2001 (66 months) at $735.84 per month.